COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

	)	
The Berkshire Gas Company	**)**	**D.T.E. 01-56**
	)	

INITIAL BRIEF OF THE

MASSACHUSETTS DIVISION OF ENERGY RESOURCES

Carol R. Wasserman
Deputy General Counsel

Matt Morais
Legal Counsel
Division of Energy Resources
70 Franklin Street, 7th Floor
Boston, MA 02110

November 14, 2001

I. INTRODUCTION AND PROCEDURAL HISTORY

On July 17, 2001, the Berkshire Gas Company (the "Company") filed with the Department of Telecommunications and Energy (the "Department") a Petition for approval of: (1) a proposed increase in revenues of approximately $ 4.6 million dollars and (2) a performance-based ratemaking ("PBR") plan incorporating a proposed price cap mechanism ("PCM"). The PCM includes: (1) a ten year term, (2) a thirty-one (31) month rate freeze (exclusive of adjustments for exogenous costs and service quality penalties), (3) annual rate increases following the initial freeze, and (4) pricing flexibility, at the Company's discretion, for large, non-residential customers. The Company did not file a Service Quality Plan with its Petition. The matter was docketed as D.T.E 01-56.

Pursuant to notice duly issued, the Department held two public hearings at which interested persons were invited to comment on the Company's filing. Pursuant to G.L. c. 12, ? 11E, the Attorney General of the Commonwealth filed a notice of intervention as of right in the proceeding. On August 17, 2001, the Massachusetts Division of Energy Resources ("DOER") filed a timely Motion to Intervene, which was granted. Petitions to intervene were also granted to Fitchburg Gas and Electric Light Company, the Low-Income Energy Affordability Network, including the Berkshire Community Action Council, Inc. ("LEAN"), and the Associated Industries of Massachusetts ("AIM"). In addition, petitions for limited participant status were granted to Western Massachusetts Electric Company, and NSTAR Gas Company.

The Department conducted seventeen (17) days of evidentiary hearings between October 3, 2001 and November 2, 2001, during which sixty-three (63) exhibits were entered into evidence.

In support of its filing, the Company sponsored the following nine (9) witnesses: Robert M. Allessio, President and Chief Executive Officer of the Berkshire Gas Company; Kenneth Gordon, Special Consultant of National Economic Research Associates, Inc.; Karen Zink, Vice President of Marketing and Resource Planning and Chief Financial Officer of the Berkshire Gas Company; John J. Kruszyna, Manager of Internal Audit and Taxes for the Berkshire Gas Company; Paul Ronald Moul, Managing Consultant of P. Moul and Associates; James H. Aikman, Vice President of Management Resources International, Inc.; Paul M. Normand, Management Consultant and President of Management Applications Consulting, Inc.; Jennifer M. Boucher, Administrator of Rates and Planning for the Berkshire Gas Company; and James L. Harrison, Management Consultant and Vice President of Management Applications Consulting, Inc. The Attorney General sponsored the testimony of Paul L. Chernick, President of Resource Insight, Inc.

On October 1, 2001, the Attorney General filed a Motion to Dismiss the Petition of the Berkshire Gas Company and in the Alternative to Bifurcate the Proceeding,[1] which was joined in by DOER and endorsed by AIM.

---

1 The Attorney General's Motion to Dismiss was brought pursuant to G.L. c. 164, ?? 1E, 94, 220 C.M.R. ? 1.06(6)(e) and Mass. R. Civ. P. 12(b)(6) for failure to plead an adequate complaint for relief. The Department, in its June 29, 2001 Order in D.T.E. 99-84; Investigation by the Department of Telecommunications and Energy on its own Motion to Establish Guidelines for Service Quality Standards for

The Hearing Officers did not rule on the Attorney General's Motion.

On October 11, 2001, DOER filed a Motion to Strike the Testimony of Dr. Kenneth Gordon. No opposition was filed by the Company. The Hearing Officers denied the Motion on October 12, 2001. On October 15, 2001, DOER appealed the Hearing Officers' decision denying the Motion to the Commission. The Commission has not ruled on the appeal.

II. SUMMARY OF DOER POSITION

DOER joins with the positions taken by the Attorney General concerning the Company's proposed rate plan, revenue requirement, and rate design.

DOER, although again joining with the Attorney General, independently addresses the following matters in its Initial Brief:

(1) The Company's failure to file a Service Quality Plan with its PBR Petition and its continuing failure to cure this integral defect in its Petition during the course of the proceedings;

(2) The Company's proposal to define exogenous costs beyond the scope of reasonability and Department precedent; and

(3) The Company's attempt to circumvent the Rolling Period Method in order to collect Lost Base Revenue to which it is not entitled, without Department review.

As set forth infra., DOER urges the Department to scrutinize these proposals and:

(1) Dismiss the Petition until such time as the Company properly prepares and files a Service Quality Plan in accordance with G.L. c. 164, ?? IE, 94 and the Department's June 29, 2001 Order in D.T.E. 99-84, or order the

---

Electric Distribution Companies and Local Gas Distribution Companies Pursuant to G.L. c. 164, ? IE.; requires gas distribution companies to include Service Quality Plans as part of their rate filings under G.L. c. 164, ? 94. The Company did not file a Service Quality Plan with its July 17, 2001 rate filing.

Company to file a Service Quality Plan consistent with the Department's Guidelines prior to the effective date of any rate increase;

(2) Disallow the Company's proposed definition of exogenous costs and modify the Petition to incorporate a definition and a process for meaningful review that is consistent with Department precedent; and

(3) Disallow the Company's proposal to collect Lost Base Revenue exceeding the Rolling Period Method as an exogenous cost without a process for regulatory review and approval.

III. SERVICE QUALITY INDICES AND REQUIREMENTS

A. Introduction

On July 17, 2001, the Company filed a Petition for a general rate increase, pursuant to G.L. c. 164 ? 94. The Company failed to file a service quality plan with its PBR proposal, violating the statutory and regulatory directives mandating inclusion of service quality plans with performance based rate plans. Furthermore, the Company failed to file any justification or alternative to its omission of the required service quality plan.[2] The Company was completely aware of the service quality requirement prior to the time it filed its petition, but chose to blatantly disregard the statutory and regulatory service quality obligation. The only reference made by the Company to the required service quality plan was a statement in the PCM that, "The Company shall present indices, benchmarks and penalties used to measure reliability and service quality performance, and any other appropriate adjustments to this plan as are consistent with the guidelines established in the

2 The Department, in its June 29, 2001 Service Quality Order in generic docket D.T.E 99-84 provided that the specific service quality standards and penalties established by the Order did not represent the exclusive means by which an electric or local gas distribution company could comply with the Department's requirements. The Order allowed for a company to deviate from the specific service quality guidelines, provided the basis for the deviation was fully set forth and supported by the filing. See Order at 41.

recently issued generic decision in D.T.E. 99-84 in a supplement to its initial filing in this proceeding." (BG-24, KLZ-1 at 3).

The Department's June 29, 2001 Service Quality Order in D.T.E. 99-84 (the "June 29th Order") established final guidelines for service quality measures, benchmarks, and penalties to be included in PBR plans submitted by electric distribution companies and local gas distribution companies pursuant to G.L. c. 164, §1E. The June 29th Order expressly provides that each company filing a petition for a general rate increase shall file a PBR plan that includes the service quality measures developed in the Order. The Department's language was absolutely clear with respect to the requirement that service quality plans had to be filed simultaneously and as part of any PBR proposal.

The Company's Petition is fatally flawed as a result of its failure to comply with the requirements of G.L. c. 164, ? 94 and the Department's June 29th Order. Accordingly, the Petition should be dismissed by the Department.

B. The Company's Refusal to File a Service Quality Plan Ignores the Requirements of G.L. c. 164, ? 94 and the Department's Order, Rendering the Petition Fundamentally Deficient as a Matter of Law

G.L. c. 164, §1E

G.L. c. 164, §1E (a) authorizes to the Department to establish and require performance-based rates for distribution companies doing business in Massachusetts. With respect to service quality standards in the context of PBR plans, c. 164, §1E (a) prescribes that the Department establish service quality standards if it chooses to implement PBR mechanisms.[3] In essence, G.L. c. 164, §1E requires that a service quality component be an integral part of PBR schemes approved by the Department. The Department is implementing PBR in the Commonwealth and, in accordance with its statutory obligation, established service quality standards in the June 29th Order.

DTE 99-84

Commencing in 1999, the Department conducted a rulemaking proceeding, docketed as D.T.E. 99-84 to establish service quality standards. The June 29th Order resulting from the generic docket proceeding unequivocally requires that all electric and gas distribution companies filing for a general rate increase pursuant to M.G.L. c. 164, § 94 file a PBR plan with a service quality component:

> "With SQ guidelines established, the Department now directs each gas and electric distribution company who files a petition under G.L. c. 164, §94 for a general rate increase to include a PBR plan containing the SQ measures developed in these proceedings. If a gas or electric distribution company submits a PBR plan that deviates from these SQ guidelines, that company shall provide full and complete support for its proposal and the reasons for any departures from the SQ guidelines stated herein." June 29th Order at 41.

3 Section 1E. (a) *The department is hereby authorized to promulgate rules and regulations to establish and require performance based rates for each distribution, transmission, and gas company organized and doing business in the commonwealth* pursuant to the provisions of this chapter. *In promulgating such performance based rate schemes, the department shall establish service quality standards each distribution, transmission, and gas company,* including, but not limited to, standards for customer satisfaction service outages, distribution facility upgrades, repairs and maintenance, telephone service, billing service, and public safety provided, however, that such service quality standards shall include benchmarks for employee staff levels and employee training programs for each such distribution, transmission, and gas company. (emphasis added)

This language clearly establishes two requirements with which, in the context of a petition for a general rate increase, a company must comply. First, the company must file a PBR plan. Second, the PBR plan must contain a substantive service quality component containing the service quality **measures** prescribed by the June 29th Order or an alternative service quality component that is adequately supported by the filing. It should be noted that the Order language only requires the PBR plan to contain the service quality **measures** developed in the June 29th Order. This distinction is important for the following reason.

The Department has established guidelines for the entire service quality component of a PBR plan. The service quality component includes three distinct parts: the measures, the benchmarks, and the penalties. The measures are the objective, generic, service quality categories/activities that each distribution company must address in its service quality plan. These measures may be "incorporated by reference" in a company-specific plan, without subjective modification.

However, the substantive performance benchmarks and penalty standards developed by the Department are not generic; they can not be "incorporated by reference" in a company- specific plan. The June 29th Order's benchmark and penalty standards are objective **formulae** that are to be applied by all distribution companies in calculating the **subjective**, company-specific performance benchmarks and penalties the company must propose to the Department to be incorporated in each specific service quality plan.[4] To

4 The Odor Calls standards and penalties are an exception to this rule. It should also be noted that penalty dead-band and assessment of application of maximum objective penalty (2%) standards are also qualifications to the subjective nature of the penalty component.

calculate the benchmarks, a company applies company-specific data to the objective formulae, thereby deriving the substantive benchmarks applicable to that company's service quality plan. The actual company performance data is then assessed relative to the established benchmarks to determine the specific penalties to be assessed against a company, up to the 2% maximum prescribed by the statute.

Due to the objective/subjective distinction between the service quality measures, the benchmarks and penalties, and the effect of that distinction upon the different service quality components, the Department mandated that a company incorporate only the objective service quality **measures**. The Department further ordered that a company seeking a general rate increase develop and propose company-specific benchmarks and penalties and incorporate them as well into its service quality plan. This distinction renders it impossible to comply with the service quality requirements of G.L. c. 164, ? 94 and the Order by merely asserting that the generic measures will be "incorporated by reference."

<u>M.G.L. c. 164 §94</u>

The Department has the statutory authority to require substantive changes to §94 filings, as follows:

> "Gas and electric companies shall file with the department schedules, *in such form as the department shall from time to time prescribe, showing all rates*, prices, and charges to be thereafter charged or collected within the commonwealth for the sale and distribution of gas or electricity, together with all forms of contracts thereafter to be used in connection therewith." (emphasis added)

The use of the modifier, "*as the department shall from time to time prescribe,*" provides that the form with which §94 petitions must comply is dynamic and can be changed/modified at the discretion of the Department. This provides the flexibility required to accommodate implementation of new policies relative to electric and gas distribution company rate regulation. The Department exercised this authority with respect to the substantive form of rate schedules filed in §94 petitions by requiring all companies filing for a general rate increase to include a PBR plan with a service quality component.

The substantive requirements of the Department's June 29th Order modified "the form" of §94 petitions by expanding the definition of "rates" in the context of §94.[5] The Company's proposed PBR plan, the platform for rate design in the Company's ? 94 Petition schedules, requires a service quality component. That component itself is a substantive factor of the equation used by the Company to calculate its proposed rates. The PBR plan, with its service quality component, is integral to the "rates" as that term is used in §94.[6]

The Department has long recognized the integral nature of service quality components to a properly functioning PBR Plan.[7] The service quality component, which is,

5 The term "rates" is not specifically defined in the context of Section 94. Rates, or rate base, means computing the company's base revenue requirement plus an equalized rate of return. Once the base is computed, a PBR Plan establishes a pricing mechanism to adjust rates up and down for the term of the plan. The pricing mechanism here is the PCM. The PCM, over the term of the plan, adjusts the rates for inflation, +/- exogenous costs, and +/- service quality penalties. The rates under a PBR Plan include, as an integral piece, the service quality component. Tr. Vol. 8 at 921, 922; BG-3 at 6.

6 The rates would not exist without the PBR plan, and, as all distribution companies have been directed by the Department to file a PBR plan, companies do not have the option of basing proposed rates on any other premise.

See Incentive Regulation for Electric and Gas Companies, D.P.U. 94-158 (February 24, 1995) at 60:

by statute, included in the Department's development of rate schemes, ensures that price-cap mechanisms in PBR plan function as intended. A price cap mechanism introduces a financial incentive for the regulated firm to reduce costs, an incentive that is offset by the inclusion of service quality requirements. See, Boston Gas Company, supra. at 304 (Phase 1) (1996); NYNEX Price Cap, D.P.U. 94-50 at 235 (1995).

As stated by the Department in NYNEX, supra. at 249:

> Because price cap regulation introduces a financial incentive for a regulated firm to reduce costs, a well-designed price cap plan must include some form of protection against a reduction in service quality for monopoly customers. This reduction in service quality would be tantamount to a price increase.

The Company's position that its intent to prospectively develop this component and that such an approach results in a well-designed, comprehensive PBR plan, is internally inconsistent. The Company's PCM itself identifies the essential role the service quality component must play, acknowledging that adjustments to the price cap index (positive or negative) to pass through cost changes are a well-recognized component of price cap plans:

> When prices are delinked from costs, there is a potential risk that the utility might be able to increase its profits by decreasing the quality, adequacy, and reliability of the services that it provides to customers. To counter this possibility, price-cap plans typically provide explicit customer service measures, which often include

---

While the primary focus of any incentive proposal should be to achieve cost reductions, the Department continues to recognize its mandate to ensure the continued delivery of safe and reliable service to the public. Contrary to the impression conveyed in the comments of some of the parties, incentive regulation does not signal the end of regulatory oversight of gas and electric utilities, but represents what may be a more effective means of achieving these and other goals than traditional COS/ROR regulation. The Department will not accept incentive proposals that result in reduced safety, nor will it permit incentive proposals to be used as a vehicle to weaken service reliability or existing standards of customer service. Furthermore, the Department insists that existing standards of customer service must be maintained or enhanced under any incentive proposal.

> mechanism whereby the firm would be penalized if it fails to meet designated customer service and reliability benchmarks. (BG-3 at 8)

The Company's price-cap model, as defined mathematically, factors in service quality as an integral component:

$$P_t / P_{t-1} - 1 = dI - X + Z$$

The terms on the left represent the rate of growth of the price cap index relative to the previous period. dI = the growth rate of the inflation measure. X = the productivity offset. Z = the measure of exogenous costs and service quality penalties. (BG-3 at 6).

Based upon both the Department's analysis and directives and the Company's own model, its PBR plan requires the inclusion of service quality measures, benchmarks, and penalties. Consequently, the failure to include the Company-specific performance benchmarks and penalties fatally undercuts the integrity of the PBR Plan.

C. The Company was Cognizant of the Service Quality Requirements and Should Not be Rewarded For Its Undermining of Department Policy by the Department's Approval of Its Fatally Deficient Petition

The Department first issued proposed service quality guidelines in its August 17th, 2000 Order in D.T.E. 99-84. The Company filed its Petition on July 17, 2001, almost a year after that order. Furthermore, the Department's intent to require a service quality component in PBR plans was clearly stated in 99-84 in the Department's original Order Opening a Notice of Inquiry/Generic proceeding, issued on October 21, 1999. Robert Allessio, the Company's senior policy witness, testified that the Company actively participated in 99-84 from the opening of the proceeding as a member of the "Joint Utilities" intervenors and was aware of the requirements in that proceeding.[8]

Further evidence of the Company's prior knowledge of the service quality requirements is provided in the Company's prefiled testimony (BG-1, BG-3) and the correspondence between the Company and their attorneys (AG-RR-38 supplemental). Mr. Allessio's and Dr. Gordon's prefiled testimony, prepared after the issuance of the Department's June 29, 2001 Order (but prior to the filing of the Petition) both reference the "recent" issuance of the June 29th Order and demonstrate that the Company's President and expert witness were aware of the service quality requirements well before the Company filed its Petition.[9]

The correspondence from the Company's counsel references the June 29th Order in the context of a discussion pertaining to the "original estimate" of legal fees (AG-RR-38 supplemental). The correspondence is enlightening both for establishing the timeframe for the Company's awareness of the requirement and for demonstrating the Company knew that actual, substantive work to develop a plan was the D.T.E. mandate. A promise of future compliance would not have required a present legal expense:

> As we noted in our original estimate, the issuance of a final decision in docket DTE 99-84 has necessitated further substantive action. As you know, we are working with Company staff in preparing a *supplemental filing on so-called SQI matters; August 16, 2001*. (emphasis added)

The Company recognized the value of substantive service quality components and,

---

8 Tr. Vol. 2 at 210, 213.

9 Dr. Gordon also testified during cross-examination that he was aware of the SQ requirements mandated by the June 29th Order. Tr. Vol. 1 at 128.

in particular, the value of the penalty mechanism in ensuring that adequate service quality is maintained in the context of a PBR plan.[10] Mr. Allessio confirmed that it is the Company's policy position that a substantive service quality plan with substantive penalty mechanisms is required in the context of a PBR plan.[11] This policy position was also expressed by the Company's retained service quality expert, Dr. Kenneth Gordon.[12]

The fact that the Company was certainly knowledgeable about the statutory and regulatory service quality requirements and, as a policy matter, claimed to support the implementation of those requirements in a PBR plan renders the failure to file a service quality plan a fatal defect to its Petition and contradicts the Company's professed policy.

D. Despite Company Testimony, No Service Quality Plan Accompanied the Petition For a General Rate Increase Filed On July 17, 2001

The Company's "service quality plan" filing was limited to a reference in its PCM that, in the future, the Company intended to comply with the June 29th Order and prepare a supplemental filing. (BG-24, KLZ-1 at 3). The Company's initial Petition did not include a service quality component. The statement that the Company "shall" present the relevant components in a "supplement to its initial filing"[13] indicate that no present service quality

---

10 Tr. Vol. 2 at 215-216.

11 Tr. Vol. 2 at 216. Despite the testimony of CEO Robert Allessio that Berkshire had presently incorporated revenue penalties into a service quality plan filed on July 17, 2001 (Tr. Vol. 2 at 219), the Company has filed no proposal in this proceeding. In fact, when pressed by the Department, Chief Financial Officer Karen Zink testified that the Company would submit a filing only after being ordered to by the Department (Tr. Vol. 16 at 1791-1795).

12 Tr. Vol. 2 at 215, 216, 219-220 and Tr. Vol. 1at 121,123, 124, 125-126.

13 It should be noted that no specific date or time frame was given by the Company. The PCM merely states that the service quality component will be developed and filed as a supplement to the original Petition, presumably at some future time.

plan existed. This defect was further evidenced by the direct testimony of Robert Allessio and Kenneth Gordon.

The relevant testimony of Robert M. Allessio states:

> Finally, the plan includes safety and service quality indices that are intended to avoid service quality degradation and that *shall be geared to be consistent with* the Department's recent order in docket DTE 99-84.[14] (emphasis added).

Cast in future tense, the testimony demonstrates that no service quality plan was submitted as part of the Petition. Mr. Allessio provided further testimony concerning the Company's intent to propose service quality mechanisms at some future time.[15] During cross-examination, Mr. Allessio again stated that it was the Company's "intention" to comply with the June 29th Order.[16]

The relevant testimony of Dr. Kenneth Gordon states:

> Berkshire *plans to accommodate* the *generic* requirements that Massachusetts has recently established *by supplementing* its PCM filing *at a later date*.[17]
>
> Berkshire *would support developing a service quality plan*, once data has been collected, that

---

14 BG-1 at 22.

15 The Company may make the argument that the PCM refers to an existing service quality plan. This argument is without merit for the following reasons. First, the testimony was provided in response to a question relative to the mechanics of the PCM plan, not the service quality plan. Second, the response clearly states that the PCM "includes" the service quality indices. The June 29th Order mandates that a PBR proposal include the service quality component. Clearly, Mr. Allessio meant the PCM when he used the word "plan" in the above response.

16 Tr. Vol. 2, at 209-211.

17 BG-3 at 29.

> would penalize failure to meet the targets but would not allow Berkshire to benefit from exceeding the performance targets.[18]

These statements by the witness provided by the Company to sponsor its service quality component cannot possibly be construed to mean present compliance with an integral element of a rate filing. The status of the Company's service quality component, or lack thereof, is also demonstrated by testimony provided by Dr. Gordon during cross-examination, when Dr. Gordon testified that he did not know what, if anything, had been filed, and that he thought the Company was still working on the plan.[19] If the plan included a substantive service quality component, presumably the Company's service quality expert would have been aware of the details of the plan.

When confronted with the fact that the filing did not contain a service quality plan, the Company shifted it testimonial gears, first claiming that the PCM incorporated by reference the generic guidelines established in the June 29th Order and subsequently identifying the Company responses to DOER Information Requests and D.T.E. Record Requests as comprised its service quality plan. See Attachment A; October 29, 2001 Service Quality Plan Submission in Generic Docket D.T.E. 99-84.

The Company's claimed incorporation of the generic standards does not achieve the functional goals/purposes underlying the service quality component of a PBR plan. The service quality requirements create an incentive for a Company to maintain an adequate level of service quality in the context of the operation of a PBR plan. Service quality

18 BG-3 at 29.

19 Tr. Vol. 1at 122-123, 125.

standards, enforced through a penalty mechanism, assess a company's actual performance relative to that company's subjective performance benchmarks. This mechanism does not exist outside of the subjective performance benchmarks required to be established. Without these elements, there is no service quality plan and no incentive mechanism. As Dr. Gordon wrote in Incentive Regulation for Electric and Gas Companies, D.P.U. 94-158 (February 24, 1995) at 60:

> While the primary focus of any incentive proposal should be to achieve cost reductions, the Department continues to recognize its mandate to ensure the continued delivery of safe and reliable service to the public. Contrary to the impression conveyed in the comments of some of the parties, incentive regulation does not signal the end of regulatory oversight of gas and electric utilities, but represents what may be a more effective means of achieving these and other goals than traditional COS/ROR regulation. The Department will not accept incentive proposals that result in reduced safety, nor will it permit incentive proposals to be used as a vehicle to weaken service reliability or existing standards of customer service. Furthermore, the Department insists that existing standards of customer service must be maintained or enhanced under any incentive proposal. (emphasis added)

The Company claims that the service quality component of its PCM plan are the generic standards. As described above, generic standards do not and can not function substantively absent the application of company specific data to the objective benchmark standard formulae. Even assuming the Company had submitted a service quality plan, a generic cut and paste would provide no incentive to maintain service quality.[20] The Department did not intend this result. Only by requiring each PBR plan to meet this requirement can the Department achieve the dual goal of realizing the potential benefits of PBR while ensuring a continued adequate level of service quality for consumers.

20 DOER Exhibit 1 at 3.

The Company's assertions that a statement of future intent to comply with the generic standards equals present compliance is an ad-hoc invention, proposed in response to a line of questioning during the evidentiary hearings that exposed the glaring defect in the Company's Petition. Once so exposed, Robert Allessio had an epiphany in the form of unsolicited "clarification" by the Company's counsel that the PCM plan incorporated the generic standards and Voila!, this was the Company's service quality plan, devoid of subjective performance benchmarks.[21] This position was never presented by the Company prior to cross-examination and is contradicted by the vast majority of evidence presented in the proceeding. Viewed in the most favorable light, the Company's present position that the PBR plan has a service quality component, is at best disingenuous. The Department should not condone this type of behavior in Department proceedings.

IV. EXOGENOUS COSTS

A. Introduction

The Company's PCM incorporates a definition for exogenous costs that would, if approved, run for the term of the ten-year rate plan, including the initial rate freeze period, without meaningful review. The definition provides a threshold for recovery of $ 50,000 in aggregate annual revenue requirements, which could be met by cumulative, $ 10,000 events. Costs are defined to be exogenous if they are beyond the control of the Company and they have, "…at least a disproportionate effect on the Company or

21 Tr. Vol. 2 at 212, 213.

(emphasis added) the natural gas distribution utility industry and not be adequately accounted for in the price index." Exogenous costs include, "[A]ccounting, legislative, regulatory, or tax changes; [A]n "Act of God" *(force majeure)*; as well as changes in laws or regulation including, but not limited to, changes in revenue or cost resulting from changes in demand-side management policy and lost base revenues not recovered through the LDAC exceeding the exogenous cost thresholds. (BG-24, KLZ-1 at 3).

The Company's proposal is unacceptable in several respects. First, the $ 50,000 threshold is disproportionately low. Second, the $ 10,000 individual and cumulative cost approach for meeting the annual $ 50,000 threshold is inconsistent with Department precedent. Third, the proposed definition itself is impermissibly broad and incorporates categories of exogenous costs that the Department has previously determined to be inappropriate. Finally, the proposal attempts to incorporate annual exogenous cost adjustments exclusively at the Company's discretion.

B. The Company's Proposed $ 50,000 Threshold Fails to Reflect the Requisite Proportionality to its Operating Revenues

The Company's proposed $ 50,000 exogenous cost threshold represents 0.103% of its average annual operating revenues over the last two years. It is similar to proposals made by Company witness Kenneth Gordon in the pending rate proceedings of Company-affiliates Connecticut Natural Gas and Southern Connecticut Natural Gas. In those pending actions, Dr. Gordon recommended exogenous cost thresholds of $ 300,000 for each company. The $ 300,000 figure represents 0.098% and 0.118%, respectively, of average annual operating revenues over the last two years for these affiliates. (DTE-RR-3). While such thresholds may be appropriate for Connecticut, they are inconsistent with Massachusetts precedent, which requires a higher threshold.

The Department addressed the need for exogenous cost thresholds in New England Telephone and Telegraph Company d/b/a NYNEX, D.P.U. 94-50 (1995) at 173, determining that such a threshold was necessary, "…in order to avoid regulatory battles about minimal dollar amounts." In Incentive Regulation for Gas and Electric Companies, D.P.U. 94-158 (1995) at 60, the Department acknowledged there may be exogenous costs that are beyond the control of a company and that it may be appropriate for a PBR proposal to allow for the recovery of these exogenous costs. However, the Department cautioned that, "Because incentive mechanisms are intended to more closely replicate market forces, incentive proposals that focus excessively on cost recovery issues may miss the point behind incentive regulation."[22]

The Department determined, in Eastern Enterprises and Colonial Gas Company, D.T.E. 98-128 (1999), that a principle of proportionality between operating revenues and exogenous cost thresholds should apply. While Colonial proposed a $ 140,000 threshold, the Department established a $ 250,000 threshold, representing 0.133% of average operating revenues. In Bay State Gas Company, Northern Indiana Public Service Company and NIPSCO Acquisition Company, D.T.E. 98-31 (1999) at 18, the Department determined that a $ 500,000 threshold, representing 0.139% of average operating

22 It is worthwhile noting that Kenneth Gordon, the Company witness proposing the $ 50,000 exogenous cost threshold, was the Chairman of the [then] D.P.U. and a signatory to both the NYNEX and the Incentive Regulation proceedings.

revenues, was appropriate. In Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company, and Commonwealth Gas Company, D.T.E. 99-19 (1999), the threshold was $ 425,000, representing 0.128% of average operating revenues. Since 1997, the Department has established a range of exogenous cost thresholds that represent between 0.128% - 0.139% of average operating revenues.[23]

Compared to the Department's determinations over the past four years, the Company's proposed $ 50,000 exogenous cost threshold, which represents 0.102% of average operating revenues, is insufficient to avoid "regulatory battles over minimal dollars." The Department should establish a minimum annual exogenous cost threshold of $ 75,000, consistent with Massachusetts precedent.

C. The Company's Proposal to Create a Cumulative Exogenous Cost Threshold is Arbitrary and Contrary to Department Precedent

The PCM provides that the $ 50,000 threshold for exogenous cost recovery would be met by including individual items over $ 10,000. (BG-24 at KLZ-1, page 3). During the first day of evidentiary hearings, Company witness Kenneth Gordon confirmed that this provision was meant to establish a cumulative threshold of (not over) $ 10,000 and to provide deferred accounting treatment for individual events. (Tr. Vol. 1 at 113 – 117).

The Department rejected the concept of cumulative thresholds in Boston Gas Company, D.P.U. 96-50 (Phase I) (1996) at 291 - 292. The Department found as follows:

> Finally, the Department rejects the Company's proposal that exogenous costs in a particular year be considered on a cumulative basis when

23 The Department initially established a lower ratio in 1996, Boston Gas Company, D.P.U. 96-50. Since then, the Department has consistently set significantly higher thresholds, as demonstrated by the Bay State, Commonwealth, and Colonial proceedings.

> determining whether the $ 500,000 threshold was exceeded. In NYNEX at 173, the Department stated that "there should be a threshold for qualification as an exogenous cost in order to avoid regulatory battles about minimal dollars." … The Department finds that, in addition to creating opportunities for "regulatory battles about minimal dollars," using a cumulative threshold would be inconsistent with the Department's directive in Incentive Regulation that PBR proposals not focus excessively on cost recovery issues." (emphasis added)

The Company has not provided any support or justification for proposing a cumulative threshold in this filing. The limited testimony provided by Kenneth Gordon further undercut the proposal, by establishing that the $ 10,000 amount itself had no objective basis:

> Q. Could you tell me the basis for the $ 10,000 threshold in Berkshire?
>
> A. I think it's a judgment as to what a reasonable level is for a company of this size before something is significant enough that it can begin to be counted—not necessarily recovered… It's a somewhat arbitrary threshold that seemed reasonable, if one thought there could be four or five events that typically happen during a relevant period, that would add to $ 50,000 and on average $ 10,000 apiece. I don't think tremendous weight can be given to the exact number $ 10,000. (Tr. Vol. 1 at 113 – 114).

The Department should reject any definition of exogenous costs that includes within it a cumulative threshold.

D. The Company's Proposal Impermissibly Expands the Department's Definition of "Exogenous Costs"

The Company's list of exogenous costs should be rejected by the Department. The proposed categories of costs are impermissibly broad, expanding beyond what the Department adopted in Boston Gas Company, supra., and the included costs themselves are undefined.

Exogenous costs have been defined to be positive or negative cost changes actually beyond the Company's control and not reflected in the Company's price cap plan. <u>NYNEX</u>, <u>supra</u>. at 173; <u>Boston Gas Company</u>; <u>supra.</u> at 291.

The Company proposes in its PCM that exogenous costs meet two criteria: (1) the cost must be beyond the control of the Company and (2) the cost must have at least a disproportionate effect on the Company or the natural gas distribution utility industry.

Concerning the first criterion, DOER agrees with the Company that the cost must be beyond the control of the Company. However, while the Company's witness, Kenneth Gordon, emphasized the importance of rigorous regulatory review in making this determination,[24] the Company's PCM proposes no standard the Company must meet or process to provide such a demonstration to the Department and other interested parties.

The second criterion provides the Company with two choices. The cost must have at least a disproportionate effect, but that effect may be on the Company **<u>or</u>** on the natural gas distribution utility industry. The inclusion of the entire natural gas distribution utility industry is impermissibly expansive.

---

24 On October 17, 2001, Dr. Gordon testified as follows:

"Q. Specifically, the Department in this letter quotes several prior decisions and states that to recover exogenous costs during a rate plan, petitioners would be required to propose exogenous cost adjustments with supporting documentation and rationale to the Department for determination as to the appropriateness of recovery of the proposed exogenous costs. In light of your experience, Dr. Gordon, what would you expect to see in the supporting documentation and rationale to which the Department makes reference?

A. I think two things. First, convincing evidence if the materiality of the exogenous event, which would obviously be subject to all the usual administrative procedures before the Department; and then also a convincing discussion of the exogeneity of it, that it really was something outside of management's' control. … It would be a fact-based regulatory proceeding to determine it. (Tr. Vol. 8 at 964 – 966).

In Boston Gas Company, supra, the Company proposed that costs would have to affect the gas industry overall, departing from the standard established in NYNEX. The Department rejected the proposal and adopted as an exogenous cost definition, cost changes resulting from:

- changes in tax laws that uniquely affect the local gas distribution industry;
- accounting changes unique to the local gas distribution industry; and
- regulatory, judicial or legislative changes uniquely affecting the local gas distribution industry. (emphasis added) Boston Gas, supra. at 291.

The Department limited the definition to costs that are unique to the local gas distribution industry, stating: "that because the price cap will apply only to the Company's distribution services, it is appropriate to refer to the local gas distribution industry, rather than the gas industry. In addition, the Department finds that it would be inappropriate to eliminate the requirement that exogenous costs uniquely affect the local gas distribution industry because cost changes that are not unique to the gas distribution industry may be reflected, to some degree, in the GDP-PI." Boston Gas Company, supra. at 289 – 290.

The Company then proposes categories of costs that would be included as exogenous. Those categories include: (1) accounting, legislative, regulatory, or tax changes, (2) an "Act of God" (*force majeure*), and (3) changes in laws or regulation, including but not limited to changes in revenue or cost resulting from changes in demand-side management policy. In addition, lost base revenues not recovered through the LDAC would also qualify as an exogenous cost.

The inclusion of an "Act of God" is impermissibly broad. The Department has established clear categories of possible exogenous costs and has provided the opportunity for case-by-case review, should a cost not fall squarely into those categories. The Company has captured those costs through adopting the "accounting, legislative, regulatory, or tax changes" language approved by the Department in Boston Gas Company, supra. at 291, as well as in Eastern-Essex Acquisition, supra. and in Bay State Gas Company, supra.

The language concerning changes in demand-side management policy and recovery of lost base revenue is redundant. Such changes fall into the category of accounting, regulatory, or tax changes and do not need to be treated separately.[25]

After review of this filing, the Department should increase the exogenous cost threshold to a minimum of $ 75,000, eliminate the cumulative threshold, and limit the definition of exogenous costs to the language approved in Boston Gas Company, supra. at 292.

25 As addressed fully in Section V., Recovery of Lost Base Revenue, the Company is attempting to capture known and measurable costs resulting from presently-existing Department regulation as exogenous costs. This is inconsistent with Department precedent and contrary to the basis for recognizing exogenous cost adjustment.

In addition to Lost Base Revenue recovery, the Company views the costs attendant to complying with a component of the Department's June 29, 2001 Service Quality Order as exogenous, despite those costs being known and measurable following the Department's Order. When asked, the Company claimed that the approximately $ 250,000 the Company claimed as necessary to respond to the telephone service factor requirement was an exogenous cost. Tr. Vol. 16 at 1841 and AG-RR-4.

V. RECOVERY OF LOST BASE REVENUE

A. Introduction

The Company proposes to define Lost Base Revenue ("LBR")[26] exceeding the limitations imposed by the Rolling Period Method, as a pre-approved, exogenous cost (BG-24 at KLZ-1, page 3). As proposed, such LBR could be collected annually by the Company, without Department review, commencing in February 2002. The proposal is completely inconsistent with Department precedent and is contrary to the public interest.

The Department originally addressed LBR recovery in Integrated Resource Management, D.P.U. 86-36-F (1988). The Department found that if an electric company demonstrated that the successful performance of its [Demand Side Management] programs would result in sales erosion that adversely affected revenues in a significant, quantifiable way, the Department would entertain specific proposals for appropriate adjustments in the company's rates. Recovery of LBR applies to both electric and gas distribution companies.

The Department determined, in Colonial Gas Company, D.T.E. 97-112 (1999), that LBR would be calculated and recovered through the application of the

---

26 Lost Base Revenue, or lost margins, are defined as the non-gas-cost portion of a gas utility's base rates that is lost between rate cases as a result of reduced sales caused by the implementation of Demand Side Management programs. Boston Gas Company, D.P.U. 90-17/18/55, at 139 (1990).

Rolling Period Method developed and approved by the Department in that case. Because the Rolling Period Method allows for the recovery of LBR for a period equal to the average, historic time span between rate cases, it provides a reasonable approximation of a company's costs that would be sought in a rate case proceeding and, thus, represents a reasonable approximation of the extent to which the company's implementation of Demand Side Management programs will, over time, permit the company to reduce the costs of providing service to its ratepayers. Further, the Rolling Period Method provides the company with a direct and consistent incentive to reduce costs and improve the efficiency of its operations.

The Company has taken the position in this filing that its Demand Side Management programs have had a significant, adverse effect upon its revenues, resulting in estimated LBR of $ 1,094,642 between 1992 - 2000 (BG-1 at 14).[27] The Company claims that the Rolling Period Method will reduce its annual revenues by $ 500,000, entitling it to claim any additional, estimated LBR as an exogenous cost that it can collect throughout the term of its rate plan, exclusive of the proposed rate freeze (BG-1 at 17).

On July 12, 2001, the Company entered into a Settlement Agreement with DOER and LEAN, to resolve all issues relating to the Company's request for pre-

---

27 The $ 1,094,642 estimated by the Company has never been reviewed or approved by the Department.

The Company also asserted that it has been committed to promoting state-of-the-art Demand Side Management programs and services that will help its customers save nearly $ 2,000,000 in 2001 (BG-1 at 14). It submitted no underlying estimates or impact evaluations to support these figures, as prescribed by the Department in Fitchburg Gas and Electric Company; D.P.U. 94-5B-CC (1994) at 32. When asked to produce the studies supporting the $ 2,000,000 figure, the Company produced a testimonial excerpt from a approval of its Demand Side Management programs; The Berkshire Gas Company Pre-Approval of Energy Efficiency Programs and Recovery of Energy Efficiency Related Costs, D.T.E. 01-29 (BG-1 at 14; Attachment A). The term of the Settlement runs for thirty-six (36) months, commencing May 1, 2001 and ending April 30, 2004. The Settlement, at Section II. H., specifically addresses LBR recovery, providing that such recovery is subject to the Department's Rolling Period Method and shall be collected through the conservation charge decimal mechanism as approved and found reasonable in the D.T.E. 98-93 Settlement.[28]

On July 17, 2001, the Company filed its request for a rate increase. The Company's Proposed PCM provides that LBR recovery will be permitted (emphasis added) over and above the limits established through the Rolling Period Method and beyond the terms of the July 12, 2001 Settlement.

The PCM provides, in relevant part, as follows:

Exogenous Costs

During the term of the plan (including the initial rate freeze period), rates would be recalculated (either increased or decreased) to reflect cost changes that are beyond the control of the Company if they have a material impact on the Company and meet the Plan's requirements for consideration as an "Exogenous Cost." The threshold for recovery will be $ 50,000 in aggregate annual revenue

prior filing, but no studies or other information supporting the claimed $ 2,000,000 (DTE-RR-2).

28 While the Company claimed it would not attempt to recover LBR as an exogenous cost until the expiration of the Settlement with DOER in 2004, the PCM does not include such a limitation, nor would the Company agree to revise the PCM to include one. When asked on cross-examination, Chief Financial Officer Karen Zink agreed that the PCM, if approved by the Department as proposed, would authorize the Company to collect LBR as an exogenous cost immediately: "Q. As set forth in the PCM terms and conditions right now, filed as part of this petition, does this language give Berkshire the authority to come in and treat as an exogenous cost lost base revenues exceeding rolling-period methodology and exceeding your threshold from the effective date of your rate case, be that February 3d, 2002, going forward? A. Yes." (Tr. Vol. 4 at 451).

requirements (with inclusion only of individual items over $ 10,000).

Costs that would be eligible for exogenous cost treatment would include:

1. Accounting, legislative, regulatory, or tax changes;

Changes in laws or regulation, which would be eligible for exogenous cost recovery, would include but are not limited to changes in revenue or cost resulting from changes in demand-side management policy. In addition, to the extent that lost base revenues not recovered pursuant to the LDAC exceed the threshold described above, an Exogenous Cost adjustment will be permitted for the amount such lost base revenues exceed the threshold. PCM II. C. 3.

The Company expressly stated that these provisions of the PCM were developed to allow the Company to recover LBR in amounts from which it would otherwise be foreclosed by applying the Rolling Period Method (BG-1 at 15, 16). The Company also asserted that, should the Department disallow its proposal to recover LBR in excess of the amount calculated under the Rolling Period Method, it would consider reducing its Demand Side Management programs.[29]

B. The Company Cannot Disregard the Limits on LBR Recovery Established By the Rolling Period Method By Redefining Lost Base Revenue

Lost Base Revenue is a unique category of expense generated as the result of long-term sales lost through implementing effective, quantifiable energy efficiency measures. The Department has acknowledged that companies are entitled to recover such losses, presuming the losses are calculated and quantified in a

29 "Q. [From the Department] So would you say that there is a strong possibility that in the future, after the expiration of the DSM Plan you're currently under, the next few years, there may be an overall reduction, perhaps, in DSM efforts? Is that a possibility? A. If the company is not allowed to consider LBR as an exogenous cost above the rolling-period method, I would say that's a true statement." (Tr. Vol. 3 at 357).

demonstrably consistent and accurate manner.

The Department has been evaluating and developing the methodology for LBR recovery since 1988; Integrated Resource Management; supra. As part of that evaluation, the Department sought to determine the extent to which alternative recovery methods would: (1) allow for the determination of net revenue lost as a result of DSM implementation; i.e., a company's base revenue that is truly lost after taking into account the opportunities to reduce the costs of electric [and gas] service; (2) provide sufficient incentive to the Company's management to reduce costs and to operate the Company's resources as efficiently as possible; and (3) be consistent with Department precedent, potentially applicable to all electric [and gas] companies, and relatively easy to administer; Eastern Edison Company, D.P.U. 94-4-CC (1994).

The Department determined, on November 17, 1999, in Colonial Gas Company; supra., that the Rolling Period Method satisfied these objectives and applied it, effective from the date of the Order forward, to all distribution companies. The Berkshire Gas Company was an intervenor in the Colonial Gas Company proceeding and was fully aware of the scope and applicability of the Rolling Period Method.[30]

30 The Colonial Gas Company argued emphatically against the imposition of the Rolling Period Method. Colonial Gas contended that changing existing LBR recovery would undermine expectations of how the Department evaluates LBR, to the financial detriment of the distribution companies. Colonial asserted that continued LBR recovery (at levels the Rolling Period Method would foreclose, if adopted) was necessary and justified and the Department's imposition of the Rolling Period Method would significantly affect the level of investment made in DSM by the distribution companies. Colonial also argued that, even if the Rolling Period Method could be fairly applied to electric companies, it could not adequately compensate gas companies.

The Department has acknowledged that, in some instances, LBR not captured through the Rolling Period Method may qualify as an exogenous cost. Such qualification, however, pre-supposes extenuating circumstances and requires a case-by-case demonstration and justification before the Department. The Company's inclusion of LBR exceeding the Rolling Period Method as a pre-approved, exogenous cost in its PCM, is an attempt by the Company to recover LBR in amounts to which it is not entitled by simply re-defining the term. The result could well be an unjustifiable Company windfall at the ratepayers' expense.

C. The Department, Not the Company, Determines Whether Lost Base Revenues Qualify As Exogenous Costs

The Company has incorporated $ 1,094,642 of estimated LBR into its base rates in this proceeding (Tr. Vol. 7 at 802, 803), which effectively zeroes out any claimed losses from 1992 – 2000.[31] Any claim that additional LBR is recoverable as an exogenous cost must be presented to the Department, not incorporated in a pre-approved definition.

The Company is well aware of the Department's requirements for demonstrating claimed LBR, over and above that which may be recovered through

---

The Berkshire Gas Company, Commonwealth Gas Company, and Fall River Gas Company ("LDCs") supported the positions asserted by Colonial Gas Company; Colonial Gas Company, supra.; at 21, which were ultimately rejected by the Department.

31 Exhibit BG-16, at PMN-6, Schedule E, page 2 of 3, line 18, shows $ 30,016,303 as the Company's proposed final base revenue target. Line 11 shows $ 28,921,661 as the base revenue recovery at the proposed ROR. Should the Department approve the Company's proposed final base revenue target, the Company will receive an additional $ 1,094,642 in lost margins as a premium over and above its proposed ROR. Allowing such a recovery is tantamount to an impermissible double collection by the Company. During the evidentiary hearing on October 23, 2001, the Company acknowledged this miscalculation, but no revisions or amendments to the Petition have been offered. (Tr. Vol. 11 at 1201 – 1202).

the Rolling Period Method, to be an exogenous cost. The Company's incorporation of an exogenous cost definition that includes LBR is an impermissible attempt to go behind the limits of the Rolling Period Method without Department scrutiny.

The Department has reviewed and rejected this approach in the past. In Colonial Gas Company-Eastern Enterprises Merger, D.T.E. 98-128 (1999), the Petitioners proposed, as does the Company here, to include any change in the Department's LBR Policy to its definition of an exogenous cost.[32] The Department determined that a change in regulatory policy, including in LBR policy, that had cost consequences, could be encompassed under the definition of an exogenous cost. However, the Department also provided that the Petitioners would be required to demonstrate the basis for proposing any LBR cost adjustment as "exogenous," with supporting documentation and rationale. Colonial Gas Company-Eastern Enterprises Merger, supra. at 53, 54.

The Department has also ruled that a company may not collect exogenous costs without Department review, as the Company proposes here for LBR recovery. In so ordering, the Department stated that:

> [T]he Petitioners' request to establish exogenous cost adjustments that would go into effect without regulatory review is not acceptable. Whether or not a cost change is actually an exogenous event is often subject to interpretation and disagreement. Bell Atlantic-Massachusetts' Fourth Annual Price Cap Compliance Filing, D.T.E. 98-67. Leaving that determination to a regulated utility would be an inappropriate delegation of regulatory authority; and, more important, it would be inconsistent with the requirements of G.L. c. 164, ? 94, which requires that a general rate increase be noticed and subject to a

32 It should be noted that Eastern Enterprises was decided on July 15, 1999, four months before the Rolling Period Method was adopted by the Department in Colonial Gas Company.

> Department hearing. Bay State Gas Company, Northern Indiana Public Service Company and NIPSCO Acquisition Company, D.T.E. 98-31 (1998) at 16, 17.

The Company asserted that the Department endorsed the pre-approved collection of LBR as an exogenous cost during the term of a rate plan, in its March 30, 2001, Letter Order in Bay State Gas Company, D.T.E. 00-106.[33] The Company's characterization of the Department's position is inaccurate. The Department rejected Bay State's proposed deviation from the application of the Rolling Period Method and reiterated its position concerning LBR recovery as an exogenous cost:

> Consequently, the Department concludes that Bay State, or any other LDC seeking to recover LBR not recouped through application of the RPRM, must submit an exogenous cost calculation filing with appropriate supporting documentation for the Department's review. The Department notes that Colonial Gas Company is currently seeking recovery in this manner in D.T.E. 00-73, and that Bay State has also considered this approach. See Bay State Petition at 9 fn. 4. Because an exogenous cost calculation filing permits the Department to conduct a comprehensive review of the cost consequences of the change in our LBR policy to determine whether recovery is warranted, we determine that this approach is in the public interest.

DOER argues that the Company's proposal to recover LBR exceeding the Rolling Period Method, through the incorporation of LBR as a defined exogenous cost in its PCM, on a pre-approved basis, for the life of a ten-year rate plan, should be rejected by the Department. Such an approach is inconsistent with Department precedent and undercuts the incentives and efficiencies provided by the Rolling

---

33 Karen Zink testified as follows: "Q. One last question on the exogenous costs, and then I will move off that. You just testified that it was indicated to Bay State and Boston Gas that the approach we just described concerning LBRs and exogenous costs should be taken. Who indicated that? A. There was a letter from the Department to Bay State that suggested to them that they may want to consider the LBR that they were losing during the term of their rate plan as an exogenous cost. I don't know if there's been a final order issued, but that's what I was referring to, and I think the same theory is being followed by Boston." (Tr. Vol. 4 at 452).

Period Method. It also impermissibly expands the definition of an exogenous cost to include known and measurable effects of regulatory policy. Finally, from a policy perspective, such an approach is not in the public interest.

V. CONCLUSION

DOER has been a consistent supporter of the Department's approach to incentive regulation and encourages the development of innovative, performance-based ratemaking. DOER also concurs with the Department's statement that:

> [A]ll incentive plans, and particularly those according a utility increased pricing flexibility,[34] must be carefully designed. First and foremost, any plan must credibly assign benefits to customers, whether in the form of lower prices or increased service, that improve on what would have been offered under current regulation. Second, a plan should not encourage or allow cross-subsidization or other anti-competitive behavior that could inhibit or suppress emerging competition. Finally, the likelihood of exceptional reward and improved financial integrity for the firm, if its performance is good, is essential to any plan. Truncating a firm's rewards unduly risks the benefits to customers that well-designed plans can offer.
>
> The Department understands that, where financial incentives are based on a benchmark or index, an otherwise unconstrained utility could have an incentive to divert resources from other goals, such as service quality and reliability, DSM, environmental management, and low-income programs, in order to enhance its performance on the benchmark criterion. It is possible, however, to design incentive plans that ensure the continued pursuit of these goals, and we expect that all plans we approve will have satisfactorily addressed these issues. Incentive Regulation, supra. at 54.

The Department must continually assess PBR plans to achieve and maintain an integral balance of competitive incentives and customer service and reliability. For those reasons, DOER recommends that the Department scrutinize the Company's Petition and:

34 The Company's PCM expressly affords such pricing flexibility at BG-24, KLZ-1, Section II. G., page 4.

1. Dismiss the Petition until such time as the Company properly prepares and files a Service Quality Plan in accordance with G.L. c. 164 ?? IE, 94 and the Department's June 29, 2001 Order in D.T.E. 99-84 or, in the alternative, order the Company to file a Service Quality Plan consistent with the Department's Guidelines prior to the effective date of any rate increase;
2. Reject the Company's proposed definition of exogenous costs, as set forth in its proposed price cap mechanism and modify the Petition to incorporate a definition and a process for Department review that is consistent with Department precedent;
3. Reject the Company's proposal to collect Lost Base Revenue exceeding the Rolling Period Method as an exogenous cost without a process for regulatory review and approval; and
4. Order any further action as determined by the Department to be in the public interest.

Respectfully submitted,

Carol R. Wasserman
Deputy General Counsel
Massachusetts Division of
Energy Resources
70 Franklin Street, 7th Floor
Boston, MA 02110
(617) 727-4732 x 126
carol.wasserman@state.ma.us

Matt Morais
Legal Counsel
Massachusetts Division of
Energy Resources
70 Franklin Street, 7th Floor
Boston, MA 02110
(617) 727-4732 x 132
matt.morais@state.ma.us

TABLE OF CASES

Bay State Gas Company, Northern Indiana Public Service Company and NIPSCO Acquisition Company, D.T.E. 98-31 (1999)

Bell Atlantic-Massachusetts Fourth Annual Price Cap Compliance Filing, D.T.E. 98-67 (1998)

Boston Gas Company, D.P.U. 96-50 (Phase 1) (1996)

Boston Gas Company, Cambridge Electric Light Company, Commonwealth Electric Company, and Commonwealth Gas Company, D.T.E. 99-19 (1999)

Colonial Gas Company, D.T.E. 97-112 (1999)

Colonial Gas Company-Eastern Enterprises Merger, D.T.E. 98-128 (1999)

Eastern Edison Company, D.P.U. 94-4-CC (1994)

Eastern Enterprises and Colonial Gas Company, D.T.E. 98-128 (1999)

Fitchburg Gas and Electric Company, D.P.U. 94-5B-CC (1994)

Incentive Regulation for Gas and Electric Companies, D.P.U. 94-158 (1995)

Integrated Resource Management, D.P.U. 86-36-F (1998)

Investigation by the Department of Telecommunications and Energy on its own Motion to Establish Guidelines for Service Quality Standards for Electric Distribution Companies and Local Gas Distribution Companies Pursuant to G.L. c. 164, ? 1E, D.T.E. 99-84 (2001).

New England Telephone and Telegraph Company d/b/a NYNEX, D.P.U. 94-50 (1995)